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Noteworthy

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The Scope of an Insurer's Duty to Defend an Additional Insured

Overview

Two recent Ontario Court of Appeal decisions have, to a considerable extent, clarified the obligations of an insurer that has agreed to provide liability coverage to persons or entities as additional insureds.

In Carneiro v Durham (Regional Municipality), 2015 ONCA 909, which involved a winter maintenance contract, the Court reversed a motion judge's decision limiting an additional insured's right to a defence. Instead, the Court found that the insurer is obligated to provide a full defence to the additional insured. Although some of the plaintiffs' allegations against the additional insured fell beyond the scope of the insurance policy's coverage, the insurer was still responsible for defending from the outset, and providing independent counsel to the additional insured. The allocation of costs attributable solely to the defence of uncovered claims, or that exceed the reasonable costs of the defence of the covered claims, are to be addressed at the end of the proceedings.

And, in Seidel v. Markham (Town), 2016 ONCA 306, another winter maintenance contract scenario, the Court of Appeal set aside the motion judge's decision, and found an agreement had been reached regarding the defence and indemnity of an additional insured, Markham, in a slip and fall action.

The reasons set out the three options available to the insurers of an additional insured; either refuse to defend and indemnify, agree to defend but not indemnify because coverage is only for the insured contractor's negligence, and defend the insured and additional insured separately, or agree to both defend and indemnify.

The Court found that because the same defence counsel represented both the additional insured and the insured after the agreement was reached, this indicated that the insurer had agreed to both defend and indemnify notwithstanding the nature of the policy coverage.

This article focuses on the Carneiro decision.

Background

On February 8, 2013, Antonio Carneiro Jr. ("Antonio") died as a result of a motor vehicle acci-

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dent on Brock Road in the Regional Municipality of Durham. During a heavy snowfall, Antonio slid on a patch of ice, lost control of his car, and slid down a hill into oncoming traffic. The plaintiffs, Carneiro's family, sued, among others, Miller Maintenance Limited ("Miller") and the Regional Municipality of Durham ("Durham"). Durham and Miller also crossclaimed against each other.

Miller was contracted by Durham to perform the plowing, sanding and salting of the area where the accident took place. The contract required Miller to obtain an insurance policy for third party Bodily Injury and Property Damage liability in the amount of $5,000,000, and to name Durham as an additional insured "in respect of all operations performed by or on behalf of" Miller. That policy was issued by Zurich. The contract also limited Miller's indemnity obligations to Durham by stating that it would not fully indemnify and save harmless Durham if the damages were caused by the negligence of Durham or its employees.

By way of a third party claim, Durham sought a declaration that Zurich had a duty to defend Durham in the action, to pay for Durham's counsel of choice, and to indemnify it for any amounts for which Durham may be found liable to the plaintiffs.

Durham's Position

Durham argued that because the plaintiffs' claims alleged a failure of Durham to remove snow and/or ice from where the accident occurred, Zurich's policy should protect Durham as this type of work fell within the mandate of Durham and Miller's contract.

Alternatively, Durham argued that the allegations of negligence not covered by Zurich are so intertwined with the allegations of negligence against Miller that it would be impossible to parse out the costs of defending the covered claims versus the uncovered claims.

Furthermore, because the agreement of indemnification between Durham and Zurich was in dispute, Zurich had a conflict of interest and Durham would require its own counsel to defend the main action. If the plaintiffs demonstrated that their damages were caused by Durham's negligent acts alone, then Zurich would not have to cover Durham. As a result, Durham alleged that Zurich had an incentive to favour one defendant over another.

Zurich's Position

Zurich asserted it did not have a duty to defend Durham because some of the allegations of negligence against Durham were beyond the scope of the policy. Although Zurich acknowledged that some claims against Durham were covered by the policy, Zurich argued that by defending Miller, Zurich was, by extension, protecting Durham from those claims simultaneously. Thus, Zurich submitted that Durham must defend against all claims on its own accord; the allocation of defence costs would ultimately be decided at a future time—should the need to do so arise.

Ontario Superior Court's Decision

In reviewing the plaintiffs' claims, Justice Lemon found that he could not determine from the pleadings what the "true nature" of the action was. Nonetheless, some of the plaintiffs' claims clearly fell beyond the scope of Zurich's policy. These allegations, some of which pre-dated Miller's involvement, were independent claims, and did not obligate Zurich to defend Durham.

In quoting Justice McLachlan (as she then was) in Nichols v. American Home Assurance, [1990] 1 SCR 801, Justice Lemon found that to the extent that the claims overlap, Zurich should not be defending a position that was not in their best interests. Thus, the insurer should defend only those claims which potentially fell under the policy, while the insured should obtain its own counsel for claims that clearly fell beyond the policy's terms. As far as defence costs were concerned, if Miller was found liable, and Durham not, then Zurich would be required to compensate Durham for the complete costs of defending the action.

Therefore, Justice Lemon ordered Zurich to only defend

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Durham in respect of those claims involving Miller, leaving Durham's own counsel to defend all other causes alleged in the Claim.

Issues on Appeal

The principal issue was whether the motion judge erred in dismissing Durham's motion for an order requiring Zurich to defend the claims made against Durham. A secondary issue was whether Zurich needed to pay for Durham's defence costs from the outset, or at the end of the proceedings after liability was addressed.

The Ontario Court of Appeal's Decision

The Court determined that Zurich was obligated to pay the reasonable costs for Durham's defence of covered claims, even if it incidentally furthered Durham's defence of uncovered claims. Ultimately, Durham will have to pay for the costs of defending any claims not covered by the policy. However, because of its "unqualified contractual undertaking to defend Durham", Zurich would have to pay for all of the defence costs from the outset and wait until the end of the proceedings to determine the appropriate apportionment of defence costs. Further, because of the conflict between the interests of Durham and Miller, and Durahm and Zurich, Durham is entitled to independent counsel at Zurich's expense.

The Court outlined its conclusions with five concise points.

First, the allegations trigger Zurich's duty to defend Durham. As was clearly stated in the Supreme Court of Canada's decision in Monenco v. Commonwealth, 2001 SCC 49, the mere possibility that a claim may fall within the policy was sufficient to trigger the duty to defend. The pleas directly related to Miller's obligations under the contract, thereby engaging Zurich's duty to defend Durham.

Second, Zurich's duty to defend Durham was an unqualified obligation requiring Zurich to defend the action not just the covered claims. The Ontario Court of Appeal in Hanis v. Teevan, 2008 ONCA 678, addressed a similar situation and stated that the insurer must pay all reasonable costs associated with the defence of claims that fall under the policy, even if those costs further the defence of the uncovered claims. The insured only has to cover costs solely associated with the defence of claims not covered by the policy.

Third, Zurich's argument that by defending Miller, Zurich was satisfying its obligation to defend Durham, has been rejected by the Court in prior cases. To accept this would be to render Durham's independent rights as an additional insured meaningless.

Fourth, the motion judge inappropriately gave preference to Zurich's interests over Durham's. By deciding that it was not in Zurich's best interests to defend Miller when both insured and uninsured claims existed, the motion judge disregarded Zurich's contractual duty to defend Durham.

Finally, the contract promised Durham a defence, and Zurich must abide by that contractual pledge from the outset. It was irrelevant that Durham might be able to eventually recover costs at the end of the proceedings if it was not found liable. The duty to defend is a separate contractual obligation, and would be "hollow" if the only obligation is to indemnify an insured at the end of the day.

In conclusion, the Court ordered Zurich to defend Durham, to provide Durham with independent counsel at Zurich's expense, and to reimburse Durham for reasonable defence costs incurred to date. However, at the end of the proceedings, Zurich is entitled to seek an apportionment of the defence costs to the extent they dealt solely with uncovered claims, or exceed the reasonable costs associated with the defence of the covered claims. The Court also reiterated that the defence duty must be determined expeditiously on the basis of the allegations in the underlying litigation read with the insurance coverage.

Commentary

The Carneiro decision appears to have definitively determined

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what the defence obligations are of an insurer that has afforded additional insured coverage. However, arguably, an issue still remains. If Durham had its own insurance, and was being defended by its own insurer until a defence was sought from Zurich, then there may have been two competing primary policies, with the obligations of each to be determined by the Supreme Court of Canada's Family v. Lombard decision.

Subject to this, and without making a distinction between defence duty cases in which coverage is for the insured directly, compared to an additional insured, the Court is definitive in saying that if one is insured as an additional insured under a policy, and some of the allegations attract a defence obligation, then a full defence must be provided, with the obligation to do so expeditiously, subject to the potential for allocation of defence costs that are not covered under the "additional insured coverage" policy.

Further, given the allocation issue, and although it is independent counsel who is defending the additional insured, one presumes that the insurer should be able to ask that detailed dockets be kept of what was being done so that allocation can be more easily addressed at the end of the litigation.

Where there are two competing insurers, each with a defence obligation, there may be other possible avenues in terms of the provision of a defence, (particularly if we are correct about determining overlapping coverage), but this will be for another day.

Firm News

Hughes Amys has a new website! If you haven't yet done so, check it out– and don't forget to look for Michael Teitelbaum's Blawg notes on recent, important case law.

We are pleased to welcome back two articling students from last year, following their call to the bar. Sonia Shantikumar will be working in our Toronto office and Caroline Mowat will be working in our Hamilton Office.

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